

Audit Report



October 2011

Performance Audit of City Treasurer's Delinquent Accounts Program

Opportunities Exist to Increase Collection of Past Due Receivables

This Page Intentionally Left Blank



THE CITY OF SAN DIEGO

October 25, 2010

Honorable Mayor, City Council, and Audit Committee Members
City of San Diego, California

Transmitted herewith is an audit report on the City Treasurer's Delinquent Accounts Program. This report is in accordance with City Charter Section 39.2. The Results in Brief is presented on page 1. The Administration's response to our audit recommendations can be found after page 23 of the report. This is the second and final report related to the Delinquent Accounts Program. The first report was issued in December 2009 and focused on past due accounts of the Development Services Department.

If you need any further information please let me know. We would like to thank City Treasurer staff for their assistance and cooperation during this audit. All of their valuable time and efforts spent on providing us information is greatly appreciated. The audit staff responsible for this audit report is DeeDee Alari, Claudia Orsi, Kyle Elser and Chris Constantin.

Respectfully submitted,

A handwritten signature in cursive script that reads "Eduardo Luna".

Eduardo Luna
City Auditor

cc: Jan Goldsmith, City Attorney
Jay M. Goldstone, Chief Operating Officer
Wally Hill, Assistant Chief Operating Officer
Mary Lewis, Chief Financial Officer
Andrea Tevlin, Independent Budget Analyst
Gail Granewich, City Treasurer

This Page Intentionally Left Blank

Table of Contents

| | |
|--|-----------|
| Results in Brief | 1 |
| Introduction | 2 |
| Background | 2 |
| Objective, Scope and Methodology | 7 |
| Audit Results | 9 |
| The Delinquent Accounts Program Achieves High Rates of Debt Recovery, but Additional Collection Tools Can Be Utilized to Further Increase Collections | 10 |
| The City Lacks an Authoritative and Effective Invoicing and Referral Policy | 14 |
| The Delinquent Accounts Program Needs to Centralize all Policies and Procedures in a Comprehensive Operations Manual | 15 |
| Conclusion | 17 |
| Recommendations | 18 |
| Appendix A – Definition of Audit Recommendation Priorities | 19 |
| Appendix B – Information on the City’s Past Due Receivables | 20 |
| Appendix C – Best Practices and Tools Used by the Program | 23 |

Results in Brief

Opportunities Exist to Increase Collection of Past Due Accounts Receivable

During the course of many years, a significant amount of money owed to the City has accumulated from past due accounts receivable. As of February 2010, unpaid past due accounts owed to the City totaled over \$100 million.¹ This money is owed by individuals, businesses and government agencies for a variety of different City services, fees and penalties. We found that the Delinquent Accounts Program (Program) follows many industry best practices and collects about 79 percent on the City's past due receivables;² however, improvements can be made to increase recovery and strengthen the City's invoicing (billing) and past due debt referral practices. Specifically, our review found that the Program and Citywide collection efforts could be improved by:

- implementing additional tools to further increase collections,
- instituting an authoritative and effective invoicing and referral policy, and
- centralizing all Delinquent Account Program policies and procedures in a comprehensive operations manual.

We made seven recommendations to help improve the rate of collections of delinquent accounts and to standardize the City's billing, referral and the collection processes.

¹ The total account receivable amount as of February 2010 shown in this report does **not** include a large Revenue Audit deficiency of \$30.7 million referred in December 2008, related to online travel companies and transient occupancy tax. According to the Revenue Audit Division Manager, the results of the audit are being disputed and a final determination on the amount due (if any) has not been made. This large debt was an unusual referral and skews totals and trends; therefore this debt was **not included** in our analysis of accounts referred to Treasurer's.

² The Auditor's collection rate calculation divided principal collected by principal referred (less principal cancelled) for all active accounts from 2005 to 2009. The calculation did not include the Revenue Audit deficiency referral from Online Travel Companies in December 2008 totaling \$30.7 million.

Introduction

In accordance with the City Auditor’s workplan, we have completed an Audit of the City Treasurer’s Delinquent Accounts Program. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the “Audit Objective, Scope, and Methodology” section of this report.

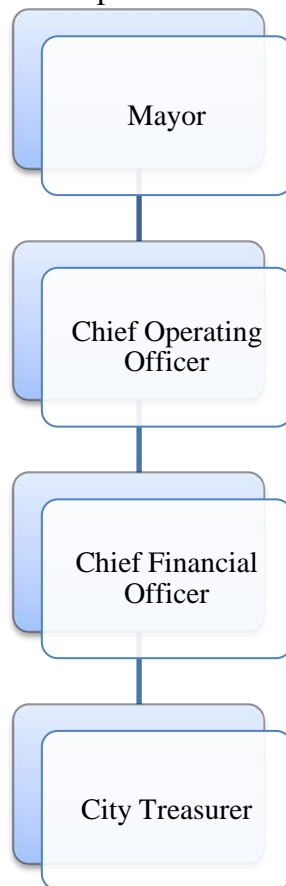
The City Auditor’s Office thanks the City Treasurer Department for giving their time, information, insight, and cooperation during the audit process.

Background

The Office of the City Treasurer is responsible for receipt and custody of all citywide revenue including banking, investment, tax administration, collection, and the accounting for these funds. These funds total approximately \$2 billion annually. The Department’s mission is: ***To receive, safeguard, and efficiently manage public funds while providing the highest level of customer service.***

The Office of the City Treasurer is a Mayoral department under the Chief Operating Officer and the Chief Financial Officer. **Figure 1** represents the organizational structure of the City of San Diego’s Financial Operations.

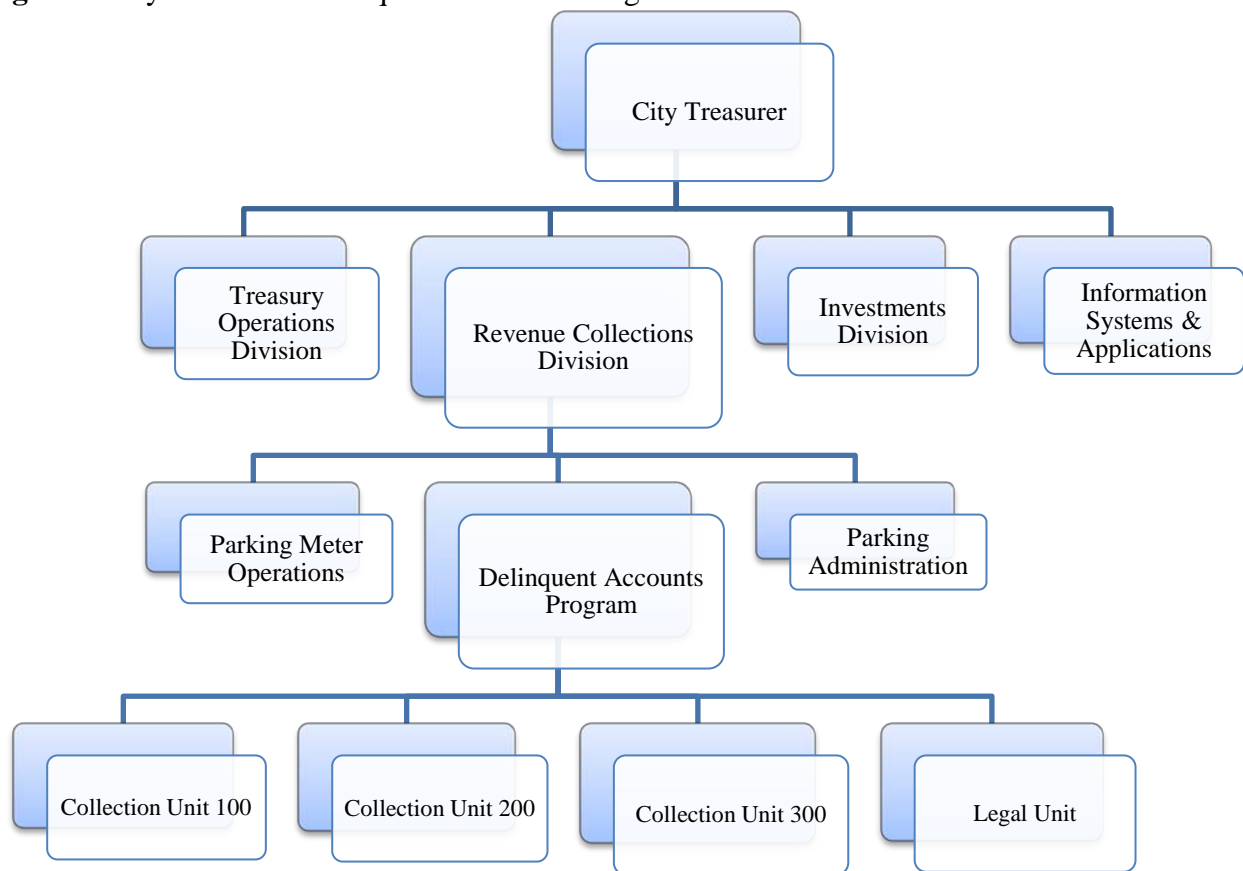
Figure 1 City of San Diego, Financial Operations



Source: City of San Diego Organizational Chart, April 2010.

San Diego City Charter Section 45 and San Diego Municipal Code §22.1707 authorizes the City Treasurer to demand and receive payment of past due accounts and to charge fees and interest on those accounts. In 1983, the City of San Diego (City) created a centralized, city-wide collections program—the Delinquent Accounts Program. The City Treasurer’s Revenue Collections Division administers the Delinquent Accounts Program (the Program) which is responsible for the administration and collection of delinquent accounts referred to the City Treasurer by other City departments and agencies. The Program also represents the City in small claims court actions on delinquent accounts. **Figure 2** represents the organizational structure of the Delinquent Accounts Program within the Office of the City Treasurer.

Figure 2 City Treasurer Delinquent Accounts Program³



Source: City of San Diego Organizational Chart, April 2010.

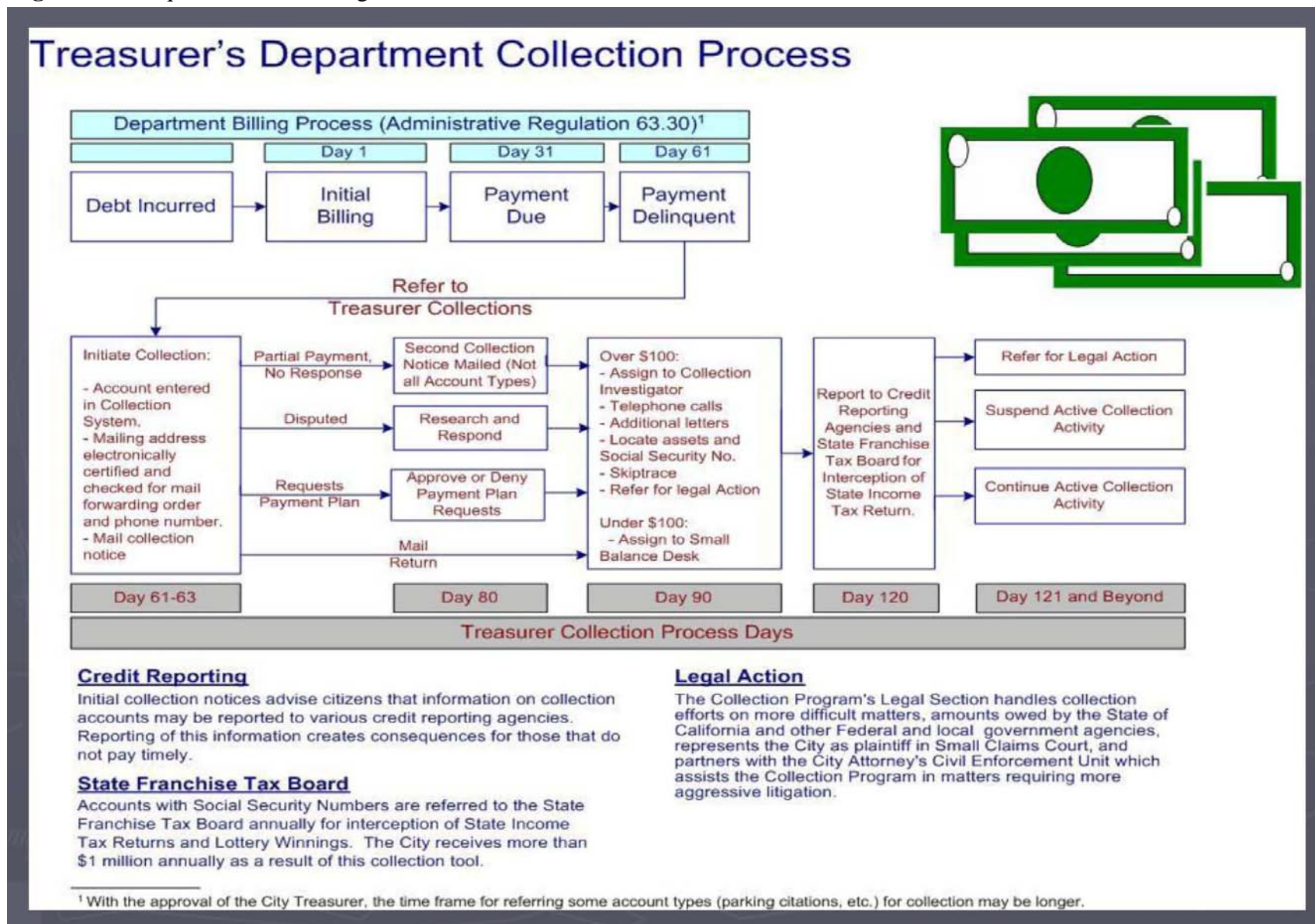
Delinquent accounts, or past due receivables, are referred to the Program by other city departments and from other divisions within City Treasurer. Referrals come from almost all City departments that invoice or collect money including the Police Department, Fire Department, Real Estate Assets Department, Development Services Department, Library, and the Park and Recreation Department – as well as referrals from other divisions and units of the Office of the City Treasurer. Examples of the types of accounts referred include business and rental unit tax, parking tickets, library fines, water and sewer bills, and police and fire fees and permits. City departments are required to make referrals of past due accounts to the Delinquent Accounts Program within 30 days of the invoice due date.⁴

The Delinquent Accounts Program uses a variety of collection procedures and tools – including credit reporting, legal action, and State tax refund interception to obtain payment from debtors. The process varies based on the type and value of the debt; however, **Figure 3** represents the general Collection Process.

³ This organizational chart represents the detail for the Delinquent Accounts Program only and does not depict the detail of other divisions within City Treasurer, nor other programs within Revenue Collection.

⁴ Administrative Regulation (A.R.) 63.30 (March 1, 2001) governs Accounts Receivable – Invoice Processing and Collection.

Figure 3 Delinquent Accounts Program Collection Process



Source: Office of the City Treasurer.

Program staffs use the Columbia Ultimate Business System (CUBS) to track and manage delinquent accounts and collection efforts and activities. All past due accounts referred to the Program are entered in CUBS. The majority of referrals are received via a system interface; however, some referrals are received manually via hard copy. A First Written Notice (Notice #1) is generated automatically by CUBS within five days of referral. After 30 days, CUBS will assign the past due account to a Collector. These assignments appear in the Collector's Work in Progress (WIP). Account assignment and placement in WIP is automatic and is based on programming within CUBS designed to prioritize accounts.

Collectors work accounts independently but are currently organized into two teams, which are collectively referred to as the Collections Floor.⁵ Each Collector has a case load of approximately 800 to 1,200 WIP accounts. Collector's "work" the accounts through a variety of collection attempts including but not limited to telephone calls, written notifications, skip tracing (the process of researching someone's identification numbers and whereabouts), and locating assets. Collectors have access to city systems and databases, subscription search services (such as Accurant), other government systems and databases, and the internet. Collectors also spend time validating debt (verifying the debt is accurate and owed), negotiating payment, bundling accounts (joining together two or more debts owed by the same debtor), and eliminating duplicates. Collectors have limited authority to adjust or cancel accounts and make payment arrangements and time extensions. Collection Supervisors review monthly cancellations and adjustments reports to ensure they are processed according to the Treasurer's guidelines.

Customers are provided a variety of payment options including in-person (cash, check, credit or debit card, and money order), online, by telephone (including wire), or by mail. Payment plans and partial payments can be negotiated.

For accounts that remain unpaid, debts are reported to the credit reporting agencies (e.g. Experian) and legal action may be pursued if there are identifiable assets. For debts of \$5,000 or less, the Program's Legal Unit pursues judgment in small claims court. Debts over \$5,000 are referred to the City Attorney's Office. With a legal judgment, the Program can place liens on property,⁶ intercept rental income,⁷ and place bank or wage levies.

All collection efforts are recorded in CUBS. A "timer" starts when a Collector begins working an account in his or her WIP. The Collector makes notes in CUBS on what collection efforts were made. When he or she is finished working that account the timer stops. This is a process captured in the daily Collector Activity Report. All account modifications (e.g. adjustments, cancellations) are also recorded. Collection Supervisors review daily and monthly reports in order to monitor Collector performance. These reports depict in detail each Collector's work efforts as well as down time. The Program's Manager utilizes a variety of CUBS reports and Excel spreadsheets to track and monitor Program referrals and recovery (collection).

⁵ Prior to the fiscal year 2010 reduction in force (RIF) the Program had three teams – Unit 100, Unit 200, and Unit 300. After the 2010 RIF, Unit 300 was absorbed into Units 100 and 200 and one (of four) Collections Supervisor position was eliminated.

⁶ In San Diego County.

⁷ On debtor Rental Unit Tax property.

Objective, Scope and Methodology

In October 2008, the City Council approved the City Auditor's Fiscal Year 2009 Audit Work Plan which included a performance audit of the City Treasurer's Delinquent Accounts Program (the Program). Work began on this audit in April 2009 and started with a review of the billing and collection practices of several City departments that refer past due accounts to the Program. During this initial review, we found significant weaknesses in the billing and collection practices of the Development Services Department (DSD) which required immediate reporting. Our first report was issued in December 2009 and focused on DSD's Deposit Accounts.

This second and final report objective focuses on assessing the effectiveness of the Delinquent Account Program of the Office of the City Treasurer and determining if opportunities exist to improve the collection of past due amounts owed to the City. To accomplish this audit objective we performed a review of the Program's structure, practices, and policies and procedures. The following audit procedures were used to evaluate the Program's effectiveness:

- Reviewed City laws and regulations related to accounts receivable, billing and collection;
- Reviewed other relevant collections and credit reporting laws and regulations;
- Reviewed Program structure and its written policies and procedures;
- Interviewed Division Management, Program Management, Program Supervisor and personnel from the City Attorney's Office;
- Surveyed and interviewed personnel from other City departments that refer past due accounts to the Program;
- Reviewed Program performance and activity reports;
- Accessed the Program's Columbia Ultimate Business System (CUBS), generated system reports, and tested system accounts;
- Analyzed Program account data; and
- Researched industry benchmarks, performance measures, and best practices.

We reviewed data from fiscal years 2006 through 2009 unless noted otherwise. We performed data reliability testing of the delinquent accounts data provided to us which we relied on in this report, and searched for indicators of fraud. We evaluated the internal controls related to our audit objectives. Our conclusions on the effectiveness of these controls are detailed within the following audit results.

The Program has administrative and cash handling functions, including a front reception cashing function. This audit did not include a review of cash handling or customer service. Accordingly, payments received were not tested or traced to bank deposits, and controls over the handling and safeguarding of payments were not reviewed or evaluated. The objective was limited to the effectiveness of the Program's collection efforts.

Data contained in CUBS includes accounts dated back into the 1980s. When analyzing total outstanding debt, for example, all accounts were included regardless of referral date. The "as of"

date for outstanding debt analyses was February 28, 2010.⁸ For other analyses including referral and collection trend analysis, data was used for fiscal years 2005 through 2009.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁸ In March 2010 the city replaced its primary invoicing system with an SAP A/R module. This audit did not include a review of SAP A/R implementation and newly referred accounts from SAP were not tested or reviewed.

Audit Results

Opportunities Exist to Increase Collection of Past Due Accounts Receivable

During the course of many years, a significant amount of money owed to the City has accumulated from past due accounts receivable. As of February 2010, unpaid past due accounts owed to the City totaled over \$100 million.⁹ This money is owed by individuals, businesses and government agencies for a variety of different City services, fees, and penalties. While almost half of this debt is five years or more past due, over \$37.7 million is less than three years old. We found that the Delinquent Accounts Program (Program) follows many industry best practices and collects about 79 percent on the City's past due receivables;¹⁰ however, improvements can be made to increase recovery and strengthen the City's invoicing (billing) and past due debt referral practices. Specifically, our review found that the Program and Citywide collection efforts could be improved by:

- implementing additional tools to further increase collections,
- instituting an authoritative and effective invoicing and referral policy, and
- centralizing all Delinquent Account Program policies and procedures in a comprehensive operations manual.

We found that the past due account referral process must be strengthened through standardization and improved inter-departmental communication and coordination. One of the most critical factors in the recovery of a past due account is timely and accurate referral. A standardized process which requires all City departments to follow Treasurer approved billing practices would help to ensure accurate and timely referrals and would improve the chance of collecting delinquent accounts. The Treasurers should establish a comprehensive Program Operations Manual that incorporates all existing policies and procedures, training materials and resources, as well as the Program's purpose, values, and mission. We have provided more detailed information on the outstanding debt balance – including an analysis by type of debt, age of accounts, and outstanding balance over time – in Appendix B of this report.

⁹ The total account receivable amount shown in this report does **not** include a large Revenue Audit deficiency of \$30.7 million, referred in December 2008, related to online travel companies and transient occupancy tax. According to the Revenue Audit Division Manager, the results of the audit are being disputed and a final determination on the amount due (if any) has not been made. This large debt was an unusual referral and skews totals and trends; therefore, this debt was **not included** in our analysis of accounts referred to Treasurer's.

¹⁰ The Auditor's collection rate calculation divided principal collected by principal referred (less principal cancelled) for all active accounts from 2005 to 2009. The calculation did not include the Revenue Audit deficiency referral from Online Travel Companies in December 2008 totaling \$30.7 million.

The Delinquent Accounts Program Achieves High Rates of Debt Recovery, but Additional Collection Tools Can Be Utilized to Further Increase Collections

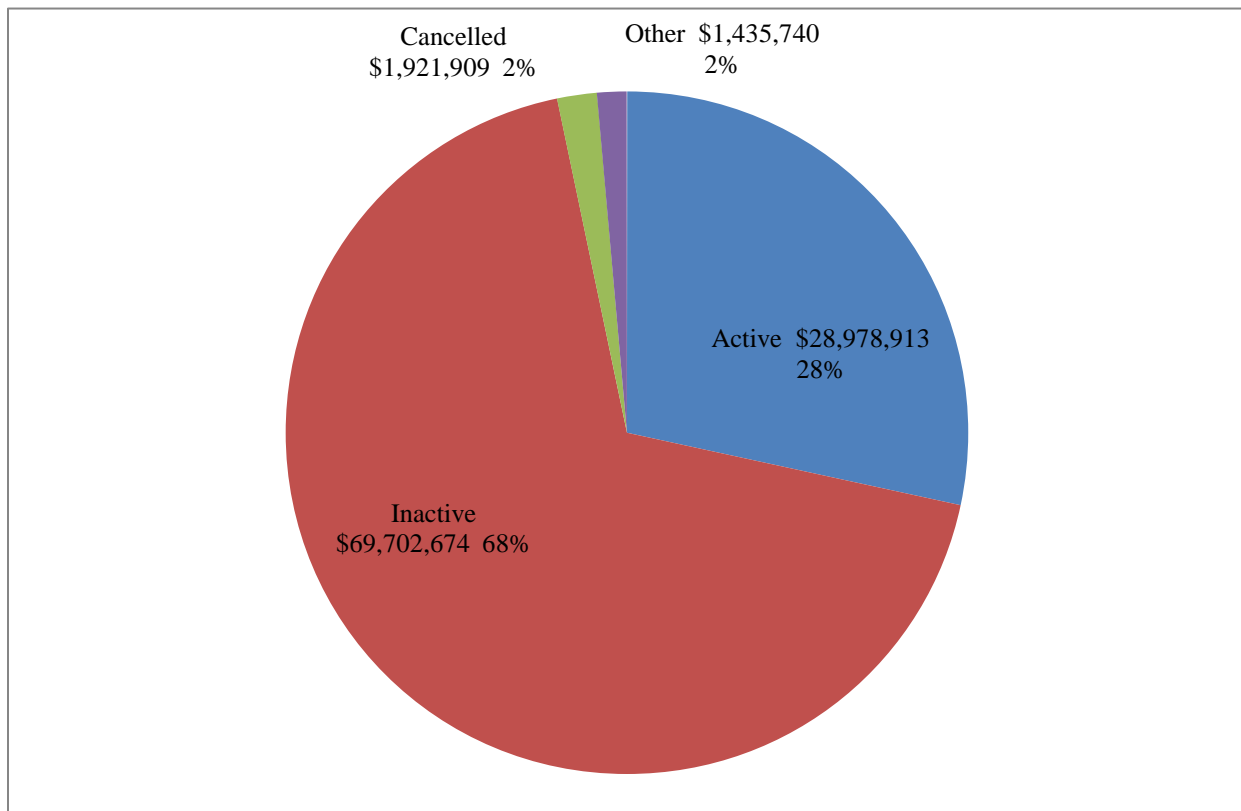
We found that the Program has a collection rate higher than the industry standard and has incorporated many best practices. Using referral and collection data for the fiscal years 2005 through 2009, we determined that the Program had a recovery rate of 79 percent.¹¹ This rate is higher than the rate of an outside collection agency (15-25 percent) and is greater than other governments that have in-house collections programs (averaging 49-65 percent) or that outsource their collection programs (averaging 39-49 percent). An analysis of Collector performance for fiscal years 2006 through 2009 showed that each Collector brings in approximately \$500,000 annually to the city.¹² We have provided a list of the best practices followed by the Program in Appendix C of this report.

Even with a 79 percent recovery rate, the outstanding amount of delinquent accounts owed to the City is over \$100 million. As seen in following **Figure 4**, the majority of the total outstanding debt is considered inactive by the Delinquent Account Program, and is therefore not included in active collection efforts.

¹¹ The Auditor's recalculation divided principal collected by principal referred (less principal cancelled) for all active accounts from 2005 to 2009. The recalculation did not include the Revenue Audit deficiency referral from Online Travel Companies in December 2008 totaling \$30.7 million.

¹² This is the gross amount collected. The cost of employing a Collector was not verified but is estimated by the department to be approximately \$80,000, including fringe benefits.

Figure 4 – Total Outstanding Debt by Status Code as of February 2010



Source: Auditor analysis of Treasurer's CUBS data.

The Treasurer codes accounts as inactive primarily for these four reasons:

| Inactive Status Description | Total Amount |
|---|---------------|
| Suspended – No response to collection efforts | \$48 million |
| Unable to locate debtor | \$8.2 million |
| Out of State | \$7.3 million |
| Statute of limitations expired | \$5.8 million |

Old debt is maintained in the Treasurer's collection system indefinitely, while the debt is written off the City's financial statements. This gives the Treasurer the ability to still collect future debt payments which periodically come into the City many years after the debt is incurred and written off the financial statements.

Statutes of limitation limit the time period in which the City can pursue litigation to collect on old debt, but there is no time limit to collect the debt via other means. While the City does periodically collect old debts, the City Treasurer could do more to attempt to collect on these stagnate accounts. Industry research indicates there are additional collection tools available to

increase recovery. According to *The Compendium of Local Government Collection Powers and Practices in the United States and Canada*¹³ the City of San Diego could pursue the following:

Third-Party Collection Agency

Third-party collection agencies should not be the primary means to pursue the collection of the City's past due receivables, but they could be used to supplement collection efforts. In-house collection is a proven best practice, and in-house collection rates far exceed those of third-party collection agencies. This is due in part to the myriad of tools available to public in-house collection agencies that are not available to third-party collection agencies. However, the City may benefit from increased recovery by outsourcing inactive accounts which are no longer being actively pursued by the Program (totaling over \$69 million) to a private collection agency.

Public List of Top Debtors

Making public a list of the most egregious debtors is an effective tool to increase recovery. In a July 2009 press release, the City of Los Angeles announced that nearly \$3 million was collected within four months of publishing that city's first public list in early 2009. Careful legal review must precede making public debtor information; however, a public list, once approved, can be an effective tool to increase recovery.

Federal Offset Program

The Treasury (federal) Offset Program (TOP) is a centralized offset program, administered by the Financial Management Service bureau of the United States Department of Treasury. TOP intercepts federal payments to payees who owe money to participating agencies that have submitted debt information. This is similar to the Delinquent Accounts Program's agreement with the State of California's Franchise Tax Board (FTB) – FTB intercepts state tax refunds and lottery winnings from tax payers who owe a debt to the City of San Diego. TOP is a similar program, but nationwide. Currently, TOP does not partner with municipalities like the City of San Diego, but serves federal agencies and some state level agencies through reciprocal agreements; however, there is a movement towards inclusion of local debt. The objective of this movement, led by Arlington County Treasurer Frank O'Leary, is to allow states participating in the federal program (TOP) to submit debt owed to localities within the state. Since, the state of California does participate in TOP, the City of San Diego should actively pursue the inclusion of municipal debt in TOP to increase recovery.

In addition to the three suggested collection tools explained above, Program supervisors indicated recovery could improve with increased access to City and other databases and systems. Specifically, Program supervisors mentioned gaining access to:

1. PACER.gov;¹⁴
2. The State of California Employment Development Department (EDD);

Furthermore, a customer's social security number (SSN) used to be visible in the City of San Diego's water utilities billing system, but Program staff indicated the SSN is now truncated.

¹³ Published by the Arlington County Treasurer, 2007.

¹⁴ Public Access to Court Electronic Records – federal bankruptcy records.

Although the Water Department does provide the social security number for customers' accounts referred to the Delinquent Accounts Program, having access to all customers' SSN could be utilized to locate debtors.

To improve the rate of collections of delinquent accounts, we recommend that the Program take the following actions:

Recommendation # 1

The Delinquent Accounts Program should assess the benefit of using a third-party collection agency to supplement its in-house collection efforts and report the results of the assessment to the Chief Financial Officer in order to take the appropriate action. (Priority 2)

Recommendation # 2

The Delinquent Accounts Program, in consultation with the City Attorney, should publish a list of top debtors on the City's public website and update the list at a set interval, such as monthly or quarterly to the extent allowable by law. (Priority 2)

Recommendation # 3

The Delinquent Accounts Program should actively pursue inclusion in the federal offset program. (Priority 3)

Recommendation # 4

The Delinquent Accounts Program should determine if additional government databases are accessible including, but not limited to, State of California Employment Development Department and court bankruptcy records. (Priority 3)

Recommendation # 5

The Delinquent Accounts Program should assess if there are other City Departments with customer data available that could be used to enhance collection efforts. This assessment should ensure the Program has maximized its access to all available City databases and systems containing customer information, such as the customer data within the Water Utilities billing system. (Priority 3)

The City Lacks an Authoritative and Effective Invoicing and Referral Policy

There are no authoritative and updated guidelines on how City departments should invoice customers and refer past due accounts to the Delinquent Accounts Program. Currently each City department bills customers according to outdated Citywide guidelines,¹⁵ and in some cases according to internal department instructions. In addition, City departments set the dollar thresholds for referral to the Delinquent Accounts Program, and the referral thresholds are not approved by the City Treasurer. During our review of three City departments, we found that departments handle billings, payments, collections, and referrals to the City Treasurer differently. For example, the Water Department refers delinquent accounts to the City Treasurer when they are 75 days overdue, the Real Estate Assets Department refers accounts after they are 90 days overdue, and the Development Services Department had past due accounts that were never referred.

Best business practices inform us that timeliness in the referral of delinquent accounts following departmental collection efforts is critical and should be within 30 days.¹⁶ Current City policy requires that City departments refer delinquent accounts within 30 days of the original invoice due date.

The Program relies on the originating (referring) department to accurately bill customers in a timely manner and to properly refer past due accounts. However, the current citywide guideline on billing is approximately nine years old and is no longer applicable under the new SAP Accounts Receivable system. Additionally, the current citywide protocol does not provide strict enough guidelines on customer billing and past due account referral. Consequently, as discussed above, we found several instances in which City departments referred their delinquent accounts considerably late.

This lack of standardization negatively affects the timeliness and accuracy of referrals, which ultimately affects an account's collectability. When delinquent accounts are transferred late, the best chance to recover the debt has already passed. In addition, as seen in our December 2009 audit report on the Development Services Department's Deposit Accounts, an effect of poor billing practices is a large amount of past due debt is not referred to the Program for collection. A standardized process which requires all City departments to follow the City Treasurer approved billing practices would ensure that timeliness and accurate referrals occur more consistently. To increase standardization and improve inter-departmental communication and cooperation, the Program should draft citywide guidelines on billing and collection to replace the current Administrative Regulation.

To develop, formalize, and implement City-wide risk mitigation processes, we recommend that the Program take the following action:

¹⁵ Administrative Regulation (A.R.) 63.30, March 2001.

¹⁶ "2009 Top Collection Markets Survey", Commissioned by ACA International – The Association of Credit and Collection Professionals. .

Recommendation # 6

The Delinquent Accounts Program should draft process narratives on billing and collection to replace Administrative Regulation 63.30. This newly crafted regulation should standardize the billing and referral of delinquent accounts across City departments and should state that departures from these standards need to be approved by the City Treasurer. (Priority 3)

The Delinquent Accounts Program Needs to Centralize all Policies and Procedures in a Comprehensive Operations Manual

The Delinquent Accounts Program does not have a comprehensive, centralized set of policies and procedures or a Program Operations Manual. The Program's written policies and procedures are contained in a series of memorandums and training program materials. A variety of subjects are addressed such as the Program's Credit Reporting Policy, Cancellation of Accounts Referred for Collection and Work in Program (WIP) Lists. Memorandum effective dates vary, and although core subject areas appear to be addressed, the Program staff could benefit from a comprehensive operations manual and centralized set of Program policies and procedures.

A comprehensive policy manual containing all procedures, processes and policies is an effective tool that maximizes government program operations. The State of Washington Department of Revenue's Field Compliance Manual is a good example of a comprehensive document which serves as a training tool and reference book for department staff. It contains the goals, values and mission, all policies (e.g. Conflict of Interest, Ethics, Confidentiality), all collections procedures (e.g. contacting by telephone, account verification, skip tracing), all available collection resources and tools, and reference to all applicable laws and regulations (e.g. credit reporting and other debtor rights).

The Delinquent Accounts Program does have training materials to assist Collectors in using the CUBS system, and the Program does have written policies on many key subject matters; however, the Program has not developed a centralized, comprehensive manual. As a new policy is implemented, Department or Program Management would draft a memo to address the new policy and the memo would be disseminated to Collection Investigators. The type and timing of collection efforts (e.g. calls and letters) are not included in the current written policies, procedures, or training materials. New employees rely on the vast experience of the Collection Supervisors to learn the best practices of collection, and primarily get on the job training regarding the tools to use and the timelines to follow.

Without a comprehensive operations manual providing a centralized location for all Program policies and procedures, vital information could be lost if and when current Program management leaves. The Program's continued success could be jeopardized by the loss of knowledge and know-how, particularly if the information is not formalized and centralized in a resource available to existing and future Collection Investigators. To ensure all Program policies, procedures, and training materials are understood and adhered to by all staff, and to

provide a comprehensive resource for the Program and the public, the Program should establish a comprehensive Program Operations Manual.

To develop, formalize, and implement a standardize collection process, we recommend the Program take the following action:

Recommendation # 7

The Delinquent Account Program should establish a comprehensive Program Operations Manual that incorporates all existing policies and procedures, newly developed policies, procedures, training materials and resources, as well as the Delinquent Account Program's purpose, values, and mission. (Priority 3)

Conclusion

“An effective revenue collection program is a major goal of any local government. The benefits of an effective program are significant, including improved revenue flow, more accurate cash forecasting, improved cash management, and greater budgetary control. In order to achieve these objectives the City must be proactive in exploring all opportunities for efficiencies that include streamlining current processes, strengthening inter-departmental relationships, and establishing efficient policies and procedures to maximize revenue collections.”¹⁷

The management of past due accounts is, and should be, a small part of the City’s entire revenue collection process. An efficient revenue collection program consists of billing and invoicing properly, appropriately accounting for cash receipts, managing accounts receivable efficiently and effectively, and referring delinquent accounts for collections in a timely manner. During 2009 we reviewed the billing and collection practices of several City departments that refer past due accounts to the Program. Our review identified problems with the City billing and referral practices. In fact, we found significant weaknesses in the billing and collection practices of DSD which required immediate reporting. Our first report was issued in December 2009 and focused on DSD’s Deposit Accounts.¹⁸

This second and final report focuses on the effectiveness of the Delinquent Accounts Program of the Office of the City Treasurer. Our review indicates that the Delinquent Accounts Program achieves good collections results, however opportunities exist to improve the collection of past due amounts owed to the City. Such opportunities include using third-party collection agency to supplement its in-house collection efforts and publishing the list of top debtors on the City’s public website.

We found that the past due account referral process must be strengthened through standardization and improved inter-departmental communication and coordination. One of the most critical factors in the recovery of a past due account is timely and accurate referral. A standardized process which requires all City departments to follow Treasurer approved billing practices would help to ensure accurate and timely referrals and would improve the chance of collecting delinquent accounts. The Office of the City Treasurer should establish a comprehensive Program Operations Manual that incorporates all existing policies and procedures, training materials and resources, as well as the Program’s purpose, values, and mission.

¹⁷ “Citywide Guidelines to Maximize Revenue Collection”, City of Los Angeles Office of Finance and Revenue Management Division Citywide Billing and Collection Program, June 2009.

¹⁸ Performance Audit of the City Treasurer’s Delinquent Accounts Program: Development Services Department Deposit Accounts, issued December 2, 2009.

Recommendations

To improve the rate of collections of delinquent accounts, we recommend that the Delinquent Accounts Program take the following actions:

1. The Delinquent Accounts Program should assess the benefit of using a third-party collection agency to supplement its in-house collection efforts and report the results of the assessment to the Chief Financial Officer in order to take the appropriate action. (Priority 2)
2. The Delinquent Accounts Program, in consultation with the City Attorney, should publish a list of top debtors on the City's public website and update the list at a set interval, such as monthly or quarterly to the extent allowable by law. (Priority 2)
3. The Delinquent Accounts Program should actively pursue inclusion in the federal offset program. (Priority 3)
4. The Delinquent Accounts Program should determine if additional government databases are accessible including, but not limited to, State of California Employment Development Department and court bankruptcy records. (Priority 3)
5. The Delinquent Accounts Program should assess if there are other City Departments with customer data available that could be used to enhance collection efforts. This assessment should ensure the Program has maximized its access to all available City databases and systems containing customer information, such as the customer data within the Water Utilities billing system. (Priority 3)

To develop, formalize and implement City-wide risk mitigation processes, we recommend that the Delinquent Accounts Program take the following action:

6. The Delinquent Accounts Program should draft process narratives on billing and collection to replace Administrative Regulation 63.30. This newly crafted regulation should standardize the billing and referral of delinquent accounts across City departments and should state that departures from these standards need to be approved by the City Treasurer. (Priority 3)

To develop, formalize, and implement a standardized collection process, we recommend the Program take the following action:

7. The Delinquent Account Program should establish a comprehensive Program Operations Manual that incorporates all existing policies and procedures, newly developed policies, procedures, training materials and resources, as well as the Delinquent Account Program's purpose, values, and mission. (Priority 3)

Appendix A — Definition of Audit Recommendation Priorities

The Office of the City Auditor maintains a classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

| Priority Class ¹⁹ | Description ²⁰ | Implementation Action ²¹ |
|------------------------------|--|-------------------------------------|
| 1 | Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring. | Immediate |
| 2 | A potential for incurring significant fiscal and/or equivalent non-fiscal losses exist. | Six months |
| 3 | Operation or administrative process will be improved. | Six months to one year |

¹⁹ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.

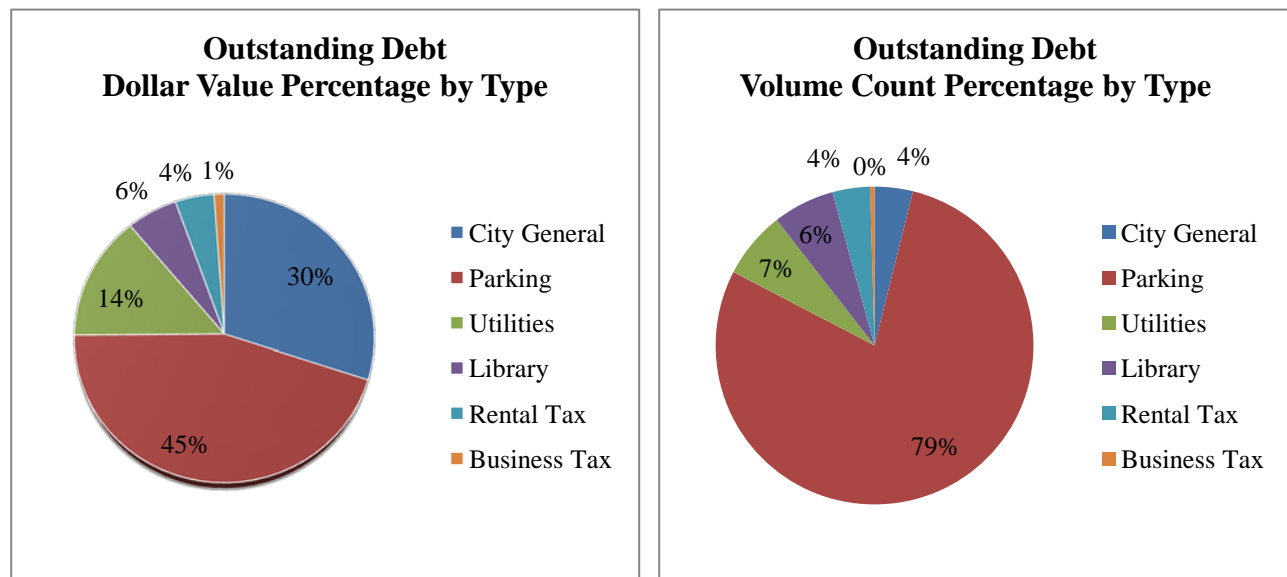
²⁰ For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$50,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$100,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its residents.

²¹ The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.

Appendix B – Information on the City’s Past Due Receivables

As of February 2010, past due debt owed to the City for a variety of services provided totaled over \$100 million.²² There are over 685,000 debts that make up the outstanding balance due to the City. The largest volume (over 539,000 or 79 percent) is parking citations. These citations total approximately \$46 million or 45 percent of the outstanding balance due. **Figure 5** below depicts the outstanding debt by type, as of February 2010, first by amount then by volume (or count):

Figure 5 – Outstanding Debt by Type as of February 2010*



Source: Auditor analysis of Treasurer’s CUBS data.

* Excluding \$30.7 million which would be part of City General.

The category type “City General” includes a wide variety of revenue types including referrals from the Police Department, Fire Department, Development Services Department, Park and Recreation Department, City Treasurer, and other users of the City-wide billing system ARIS. Individual debt amounts vary dramatically. An analysis of debtors who owe \$10,000 or more revealed that fewer than 400 debtors (less than .06 percent) owe more than 19 percent of the outstanding balance due, or approximately \$19.8 million.²³

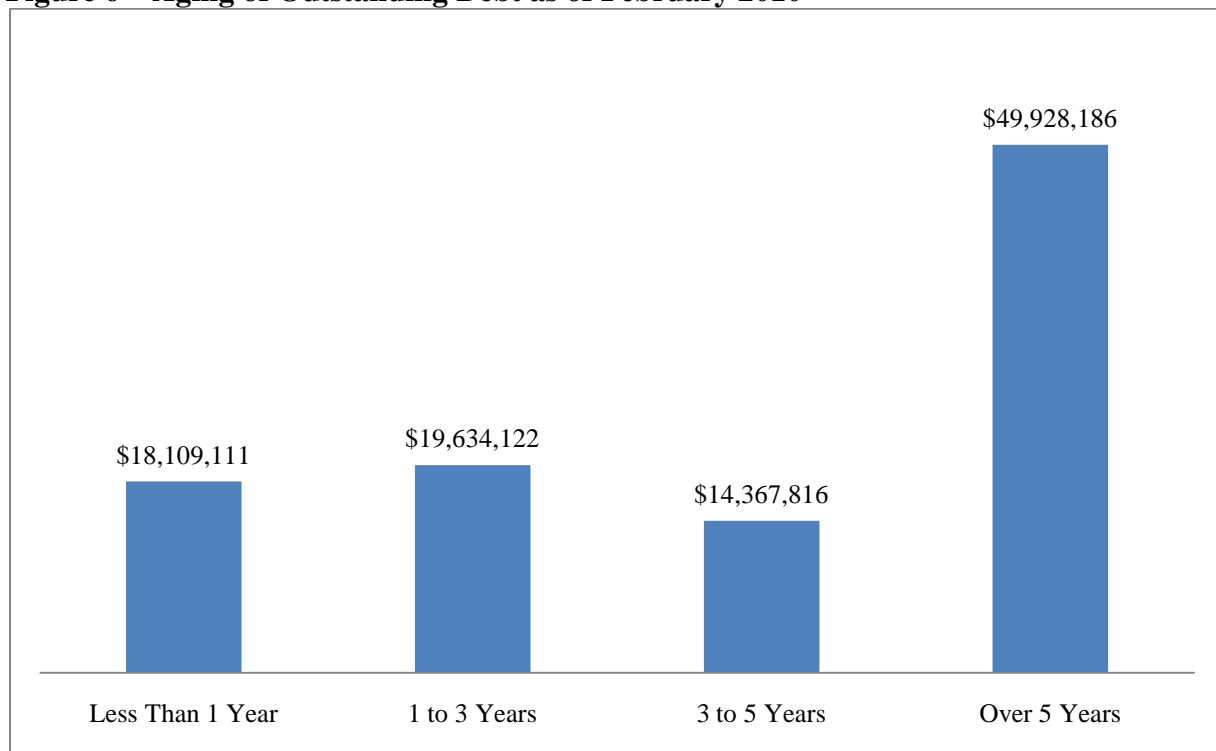
It should be noted that the collection system CUBS contains accounts that date from the 1992. Debts are not deleted from the system; therefore, the outstanding debt depicted in this report

²² This total does **not** include a large Revenue Audit deficiency of \$30.7 million, referred in December 2008, related to online travel companies (OTC) and transient occupancy tax. Accordingly to the Revenue Audit Division Manager, the results of the audit are being disputed and a final determination on the amount due (if any) has not been made. This large debt was an unusual referral and skews totals and trends; therefore this debt will **not be included** in Audit Result charts.

²³ This does not include the OTC debts.

includes decades of referrals. Although there are a variety of statutes of limitation, depending on the type of debt, which limit the time period the City can pursue litigation, there is no time limit to collect the debt via other means. Therefore, the Program keeps all debts in CUBS, regardless of age, in hopes of successful collection in the future. Consequently, total debt outstanding has been increasing steadily over time. **Figure 6** below depicts the aging of the outstanding debt as of February 2010, after adjusting for the OTC audit deficiency (which would increase the 1 to 3 year category by \$30.7 million). As the chart shows, approximately half the outstanding debt is over 5 years old.

Figure 6 – Aging of Outstanding Debt as of February 2010*

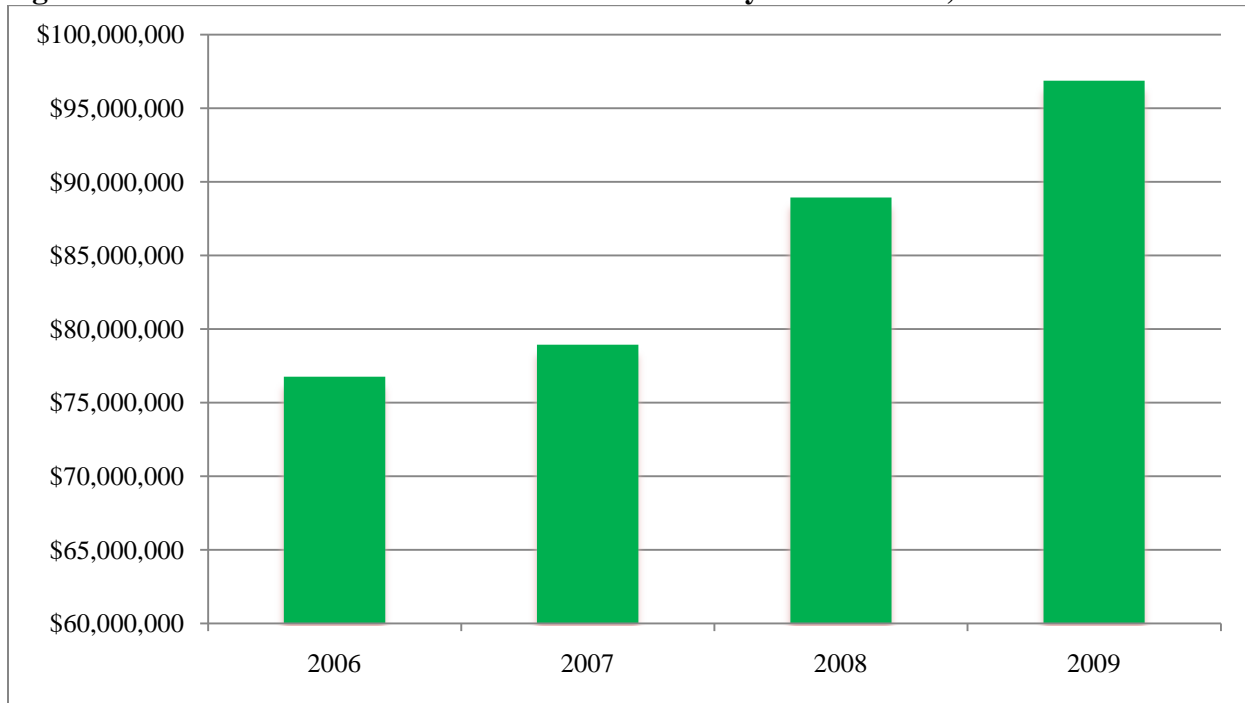


Source: Auditor analysis of Treasurer's CUBS data.

* Excluding OTC audit deficiency which would increase the 1 to 3 year category by \$30.7 million.

Figure 7 below depicts total outstanding debt (excluding OTC debt) owed to the City as of June 30 for fiscal years 2006 through 2009. It shows that the outstanding debt increased from \$73,446,710 in July 2005 to \$96,865,522 in June 2009. **Figure 8** below shows the outstanding debt by month for fiscal years 2006 through 2009.

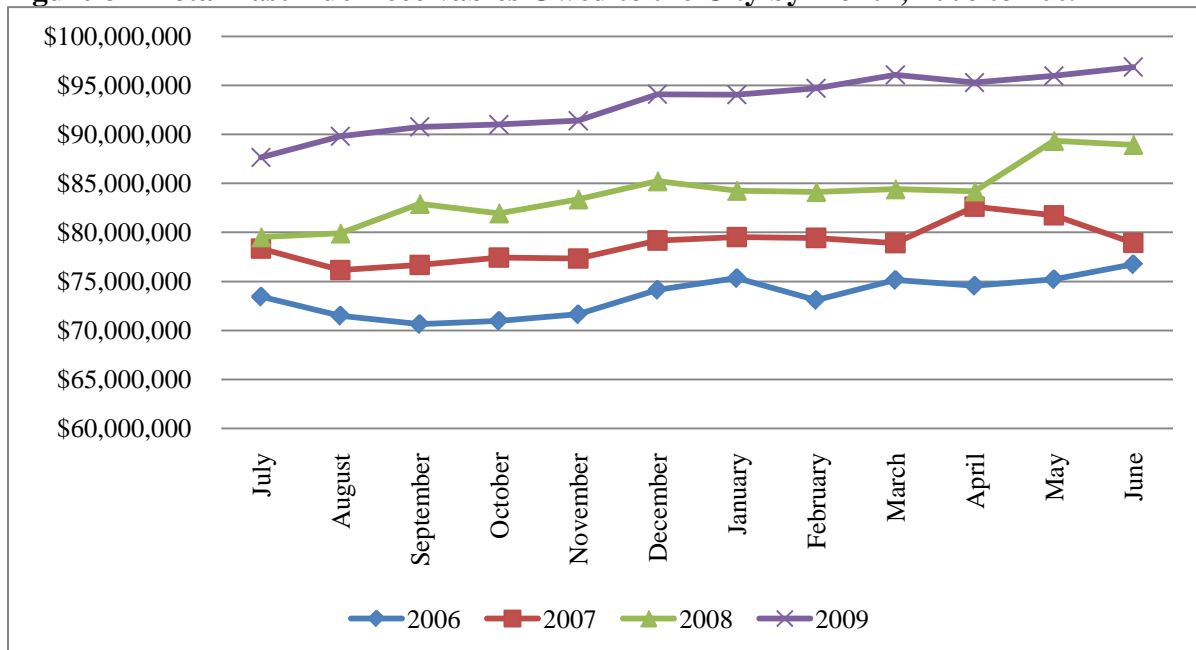
Figure 7 – Total Past Due Receivables Owed to the City as of June 30, 2006 to 2009*



Source: Auditor generated using CUBS Summary Aging of Outstanding Referrals by Fund, by Account Reports

* Excluding \$30.7 million for fiscal years 2008 and 2009.

Figure 8 – Total Past Due Receivables Owed to the City by month, 2006 to 2009*



Source: Auditor generated using CUBS Summary Aging of Outstanding Referrals by Fund, by Account Reports

* Excluding \$30.7 million for the months of December 2008 through June 2009.

Appendix C – Best Practices and Tools Used by the Program

Industry research showed the Program follows many industry best practices including:

- using a centralized, in-house team as the primary means of collection;
- benchmarking and goal setting, and tracking collector performance; using a collections-specific system for tracking and monitoring debts and maximizing automation and use of technology;
- providing a variety of payment options and payment methods;
- assigning accounts to specific collectors and maintain reasonable case loads; and
- monitoring Program performance through a variety of reports including account aging.

Additionally, the Program utilizes collection tools available to public sector treasurers such as:

- disruption of City service;
- credit reporting;
- penalties and interest;
- skip tracing tools including, but not limited to:
 - access to many City systems containing customer data;
 - subscription services such as Lexis Nexus;
 - access to the Department of Motor Vehicles database;
 - access to the San Diego County fictitious filing database and Assessor's Office (property) database;
 - access to the State of California Contractors State Licensing Board database; and
 - general internet access.
- partnership with the State of California Franchise Tax Board to intercept State tax refunds and lottery winnings;
- property liens on Rental Unit Tax property;
- vehicle impound; and
- legal action.

If legal action results in a judgment for the City, the Program has these additional tools it uses to increase recovery:

- intercept rental income on Rental Unit Tax Property;
- lien on property owned in San Diego County; and
- bank and wage levies.



THE CITY OF SAN DIEGO

M E M O R A N D U M

DATE: October 22, 2010

TO: Eduardo Luna, City Auditor

FROM: Gail R. Granewich, City Treasurer

A handwritten signature in blue ink, reading "Gail R. Granewich".

SUBJECT: Response to Draft *City Treasurer's Delinquent Accounts Program Audit Report*

This memorandum is in response to the City Auditor's October 2010 *City Treasurer's Delinquent Accounts Program Audit Report (Audit Report)*. The following specific responses are provided to the Audit Report recommendations:

Recommendation 1: *The Delinquent Accounts Program should assess the benefit of using a third-party collection agency to supplement its in-house collection efforts, and report the results of the assessment to the Chief Financial Officer in order to take the appropriate action. (Priority 2)*

Response: Agree with recommendation. As a matter of course, the Office of the City Treasurer continually assesses whether or not the Delinquents Accounts Program is performing at or above its benchmark in the collections industry. As stated in the Audit Report, "In-house collection is a proven best practice and in-house collection rates far exceed those of third-party collection agencies." With regard to inactive accounts no longer being actively pursued by the Delinquent Accounts Program, an assessment will be made regarding the effectiveness of supplementing in-house collection efforts by April 30, 2011.

Recommendation 2: *The Delinquent Accounts Program, in consultation with the City Attorney, should publish a list of top debtors on the City's public website and update the list at a set interval, such as monthly or quarterly to the extent allowable by law. (Priority 2)*

Response: Partially agree with recommendation. The Office of the City Treasurer will consult with the City Attorney's Office to determine what is legally appropriate in light of the applicable federal and state privacy and debt collection laws and what risks may be involved, if any. The City of Los Angeles currently publishes a quarterly listing of the top 250 tax delinquencies in excess of \$100,000. This publication is directed by their Municipal Code. If it is determined that such a publication is appropriate for the City of San Diego, criteria will be formulated

relative to specific debts applicable for publication. Discussions with the City Attorney's Office will occur by April 30, 2011.

Recommendation 3: *The Delinquent Accounts Program should actively pursue inclusion in the federal offset program. (Priority 3)*

Response: Agree with recommendation. The Delinquent Accounts Program will obtain information on program participation and, if feasible, will seek to implement by the end of the first quarter of Fiscal Year 2012.

Recommendation 4: *The Delinquent Accounts Program should determine if additional government databases are accessible including but not limited to, State of California Employment Development Department and court bankruptcy records. (Priority 3)*

Response: Agree with the recommendation. The Delinquent Accounts Program will make this determination by the end of Fiscal Year 2011.

Recommendation 5: *The Delinquent Accounts Program should assess if there are other City Departments with customer data available that could be used to enhance collection efforts. This assessment should ensure the Program has maximized its access to all available City databases and systems containing customer information, such as the customer data within the Water Utilities billing system. (Priority 3)*

Response: Agree with the recommendation. The Delinquent Accounts Program will make this assessment by the end of Fiscal Year 2011.

Recommendation 6: *The Delinquent Accounts Program should draft process narratives on billing and collection to replace Administrative Regulation 63.30. This newly crafted regulation should standardize the billing and referral of delinquent accounts across City departments and should state that departures from these standards need to be approved by the City Treasurer. (Priority 3)*

Response: Agree with the recommendation. The Office of the City Treasurer is currently reviewing Administrative Regulation 63.30 for the purpose of updating procedures and documentation that have become outdated and/or replaced by the new SAP Accounts Receivable system. Process narratives will be drafted by the end of the first quarter of Fiscal Year 2012.

Recommendation 7: *The Delinquent Accounts Program should establish a comprehensive Program Operations Manual that incorporates all existing policies and procedures, newly developed policies, procedures, training materials and resources, as well as the Delinquent Account Program's purpose, values and mission. (Priority 3)*

Eduardo Luna, City Auditor
October 22, 2010
Page 3 of 3

Response: Agree with the recommendation. A comprehensive program operations manual will be developed by the end of the first quarter of Fiscal Year 2012.

cc: Jay M. Goldstone, Chief Operating Officer
Mary Lewis, Chief Financial Officer
Wally Hill, Deputy Chief Operating Officer
DeeDee Alari, Revenue Collection Manager
Diana Muzquiz, Delinquent Accounts Manager
Kyle Elser, Audit Manager